

***Remarks by David N. Smith,
Executive Vice President & Chief Financial Officer
Tennessee Valley Authority
at the TVA Financial Analyst & Investor Meeting
March 28, 2002 – New York, New York***

INTRODUCTION

DNS 1 : TVA . . . FINANCIALLY SOLID

Thank you, Ike.

You've all noticed by now that all of us are preoccupied with making sure TVA remains financially solid . . . even as the electric power industry is restructured and becomes more competitive.

I want to assure you that TVA is financially healthy today. But I need to do more than that I need to reassure you that TVA will remain financially strong well into the future. To do that, I need to guide you to the right measures of TVA's financial health.

MEASURING TVA'S FINANCIAL HEALTH

DNS 2: MEASURING TVA'S FINANCIAL HEALTH

Our financial health, like that of other public-power entities, has to be measured in the context of our operating purpose.

And that makes a fair assessment of our financial condition more challenging. . . especially when you compare us to investor-owned utilities using the industry's common financial metrics.

TVA was not created to produce wealth for a group of shareholders. It was created to generate prosperity for the people of the Tennessee Valley

CASH FLOW

But one useful financial metric that TVA has in common with the investor owned utilities is the simple measure of operating cash flow.

Fundamentally, the most obvious measure of financial health for any company . . . including TVA . . . is whether the company can pay its bills, service its debts and still provide the capital required to finance the growth of its business.

TVA is in good shape on this measure.

You've already heard that TVA generated revenue of almost \$7 billion last year. And as revenue increased, cash flow increased, as well.

TVA's cash flow from operations before interest expense was almost \$3.5 billion, providing a more than ample cushion to service our capital structure and fund the reinvestments required for our business growth.

INTEREST COVERAGE

Obviously, growth in cash flow, coupled with a declining interest burden has made possible dramatic improvement to our interest coverage ratio . . . surpassing the two-times coverage benchmark in 2001.

At 2.18 times coverage, the ratio is now 54 percent better than it was in 1995!

DNS 4: CASH FLOWS FROM OPS AFTER INTEREST EXPENSE

The leverage is obvious. Last year, after subtracting interest expense, cash flow was \$1.885 billion. In fact, TVA's cash flow from operations after interest expense has improved 135 percent since 1995!

Looking ahead, I wish I could assure you that our cash flow will be higher still when I talk to you this time next year . . . but that is unlikely. Interest expense may still decline, but our cash flow is being "tested" by the dual effects of a mild winter and a challenging year for hydro generation.

Before I leave the subject of interest coverage, I should remind you why TVA's interest coverage ratio is exciting to us, even though it may be modest compared to an investor-owned utility. Remember the differences in our capital structure . . .

CAPITAL STRUCTURE

DNS 5: TVA VS. IOU CAPITAL STRUCTURE

TVA requires about the same amount of total capital as other utilities . . . but our options for obtaining those dollars are far more limited.

TVA cannot issue stock and is effectively limited by its charter in the amount of "profit" it can generate for reinvestment in the business . . . so we have to meet most of our capital needs by issuing debt.

Investor-owned utilities, of course, are able to raise capital through the more customary mixture of common and preferred stock . . . short- and long-term debt . . . tax deferrals . . . and maximizing profit for reinvestment.

For each of us, though, the cost to service all the components of our capitalization must be covered from cash flows from operations . . . so, naturally, an IOU's interest coverage ratios would have to be quite a bit greater than TVA's.

I made the statement that our cash flow provided ample cushion to service our capital structure *and* fund the reinvestments required for our business growth.

In fact, there's even been some left over each year to reduce the burden of debt.

REDUCE DEBT BURDEN

DNS 6: DEBT DECREASES WHILE CAPACITY INCREASES

Cash flow over the last few years has enabled us to reduce our overall level of debt by \$2.3 billion since 1997 . . . including the \$610 million reduction in 2001 that Chairman McCullough referred to earlier.

This debt reduction is all the more noteworthy considering the increases in capacity that we have funded simultaneously. As Ike told you, just last year we increased our net winter dependable capacity by almost 900 megawatts.

In short, we are not only using less debt, we are using our debt more efficiently!

DNS 7: COMPARISON OF TOTAL DEBT OUTSTANDING PER KWH OF CAPACITY

TVA's efficiency in using debt can be measured by comparing total debt outstanding with total generating capacity.

Measured that way, our debt burden has decreased from \$986 per kilowatt of capacity in 1996 to \$836 last year . . . an improvement of more than 15 percent!

But, again I have to remind you that if the absolute number looks high . . . remember the uniqueness of TVA's "all-debt" capital structure.

DNS 8: MARKET VALUE CAPITALIZATION

The reality is that TVA, together with its power distributors, use *about the same* amount of total capital to finance our power system as other integrated, investor-owned utilities.

It's just in a different form.

When all the sources of capital are considered . . . book values for those that are fixed and market value for the ones that aren't . . . the total capitalization of TVA and the distributors of TVA power is comparable to the total capitalization of the average investor-owned utility.

INTEREST EXPENSE

Let me share another measure of the efficiency of our capital . . . and that's our interest burden compared to revenues.

DNS 9: NET INTEREST EXPENSE AS % OF REVENUE

While we've aggressively reduced the absolute level of debt, we have also aggressively worked to reduce the interest rates on the remaining debt balances.

Today, TVA's average effective interest rate is about 5.8%, compared to 7.3% just five years ago.

The combination of lower debt and lower rates means we've reduced TVA's annual interest expense by \$370 million from its high in 1997.

TVA's net interest expense compared to total annual revenue . . . another indication of how TVA leverages its debt . . . is the lowest it's been in 15 years.

In fact, net interest expense as a percentage of revenue has decreased a third since 1997 . . . and we certainly appreciate your help on this!

COMPETITIVE PRICE

The surest measure of TVA's health, now and in the future, is our competitive position . . . and TVA is in excellent shape in this arena.

Ike showed you what an outstanding job the operations team is doing to keep our production costs among the lowest in the nation. I've tried to reassure you that we're doing our part on the financing front as well.

But, the single best measure of TVA's overall operating and financial performance in relation to other utilities is to compare our total delivered cost of power.

The true test of competitiveness comes down to the price the consumer pays.

DNS 10: US MAP WITH RESIDENTIAL PRICES

I'm pleased to tell you that the price of electricity for the more than 8 million residents of the Tennessee Valley was 6.4 cents per kilowatt-hour last year . . . 22 percent below than the *national* average residential price . . . and 20 percent lower than the *regional* average.

DNS 11: CY 2000 AVERAGE PRICE COMPARISON

Not only are residential prices in the TVA service area competitive, but commercial prices in the area served by TVA are 14 percent below the national average . . . and industrial prices are 16 percent lower. While these rates are good comparatively, we are working to make our commercial and industrial rates even more competitive.

TVA enjoys very competitive rates today . . . and we are working hard to be the provider of choice in our region as our industry becomes more competitive.

That's where we are today.

PREPARING FOR THE FUTURE

DNS 12: FINANCIALLY SOLID TODAY...AND TOMORROW

Now I want to give you a glimpse into the future to reassure you that we are taking the right steps to strategically position ourselves for the competitive environment of tomorrow.

Let me share three examples of how we are financially preparing for the future.

RISK MANAGEMENT

DNS 13: MANAGING RISK

We all know that as the industry undergoes restructuring, electric power providers will be exposed to new challenges and new risks.

TVA, though, is taking a proactive approach in managing risks to maintain sound financial and operationing performance . . . and to make sure our power prices continue to be competitive.

TVA is very risk averse. Consequently, our risk policies are very conservative.

DNS 14: RISK MANAGEMENT ORGANIZATION CHART

Our focus is to proactively manage activities that pose a potentially high risk to TVA . . . in our operations . . . our credit . . . and our markets.

We do this by ensuring proper management oversight . . . along with mitigation of risks . . . governed by stringent internal controls, including an independent Inspector General.

ASSET VALUATION

DNS 15: REDUCING ASSET CARRYING VALUES

A second example of how we're improving our future competitive position is apparent from our actions to accelerate the amortization and depreciation of certain assets . . . as several investor-owned utilities have done in past years.

Last year, we determined that the book values of some existing TVA assets would not be appropriate in a competitive marketplace. Simply speaking, we estimated that the amount of cash these assets would provide through future rates was likely to be less than their recorded book values.

So, we reduced the carrying amount of these assets by \$3.4 billion and recognized an “impairment loss.”

Fortunately, we were able to absorb those charges against our retained earnings, rather than through rate increases, commonly referred to as “transition charges.”

LEASE FINANCING

DNS 16: PURSUING FLEXIBLE FINANCING ARRANGEMENTS

A third example of how we’re managing the uncertainty facing our industry is through our use of lease financing transactions.

TVA financed eight combustion turbines in fiscal year 2000 and an additional eight combustion turbines in November 2001 using lease-leaseback transactions.

As you know, this type financing allows TVA to transfer to a private investor the risk of residual value of these units at the end of their useful lives... retaining, however, a TVA option to purchase the units at the end of the lease. The financings also provide TVA options for early termination of the lease arrangements twice, prior to the end of the 20-year lease term.

TVA's lease payments are treated as an operating expense and the leases are recorded as a liability on our balance sheet.

Those of you in the room can appreciate the cost-effective approach to this financing. This type of financing makes good business sense because it provides TVA with greater financial and operating flexibility during the transition to a competitive marketplace.

And, I might add, it's pretty cheap money, as well!

CONCLUSION

DNS 17: TVA . . . FINANCIALLY SOLID

TVA is financially solid today and we are determined to remain so in the future.

We will continue to look for innovative ways to run TVA like a competitive business while meeting the many different demands that TVA has to balance . . . with the ultimate goal of providing the best service possible for the people of the Tennessee Valley.

Thank you.

Now I'll turn it back over to Sissy to moderate our panel.

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